

October 14, 2003

Honorable Mayor and Members
of the City Council
City of Farmington Hills
31555 W. Eleven Mile Road
Farmington Hills, MI 48336

Dear Mayor and Council Members:

We have recently completed our audit of the financial statements of the City of Farmington Hills for the year ended June 30, 2003. In addition to our audit report, we offer the following comments and recommendations for your consideration:

NEW FINANCIAL STATEMENT FORMAT (GASB 34)

As you are aware, Governmental Accounting Standards Board (GASB) Statement No. 34 was implemented for the City's 2003 fiscal year. GASB 34 has dramatically changed the look and feel of the financial statements. While the financial statements retain an element of familiarity with the continued reporting of fund based information, there are several additions and changes that provide information never before presented in the City's annual financial report. A brief summary of the changes are as follows:

- Management Discussion and Analysis (MD&A): The MD&A provides a high-level overview of the City's financial position and results of operations, with a focus on the government-wide financial statements.
- Government-Wide Financial Statements: These additional statements adjust the normal fund-based statements into a combined, full-accrual format (similar to for-profit commercial enterprises). This allows a financial statement reader to see the City from a longer term, economic perspective (i.e. are today's taxpayers paying for today's services?). These statements show capital and infrastructure assets, as well as long term debt as part of the City's overall financial picture.
- Focus on Major Funds: The fund based financial statements now focus on the City's most significant funds (major funds). For 2003 the City's major governmental funds are the General Fund, Major Road Fund, Local Road Fund, Capital Improvement Fund, SAD Debt Service Fund, and the SAD Capital Projects Fund; the City's major enterprise funds are the Water and Sewer Fund and the Ice Arena Fund.

- **Budget Comparison:** A financial statement reader will now be able to view not only the actual revenues and expenditures for the City's major funds as compared to the current budget, but also as compared to the original budget.

OVERVIEW OF THE CITY'S FINANCIAL CONDITION

During the year ended June 30, 2003, General Fund expenditures exceeded revenues by approximately \$2.9 million, taking into account transfers to other funds. Fund balance at June 30, 2003 totaled approximately \$16.1 million. Of this amount, \$2.5 million is reserved for encumbrances and long-term advances, \$7.9 million is designated for future technology and capital improvement expenditures and \$5.7 million is undesignated. The undesignated portion represents approximately 11.5 percent of the following years budgeted expenditures. This percentage is consistent with prior years and within the range typically expected by rating agencies.

By maintaining an adequate level of fund balance the City is able to adjust to expected and unanticipated (see State Shared Revenue comments below) financial changes without affecting the level of services provided to citizens or the City's ability to fund future capital needs and long-term obligations. We compliment the City Council and department heads for their continued success with financial planning and budgeting.

REVENUE SHARING

Reduced sales tax collections and significant budget shortfalls at the State of Michigan continue to negatively impact the City as a result of reduced State shared revenue payments. State shared revenue payments, which totaled approximately 17 percent of the 2003 General Fund Budget, decreased from the payments received in 2002. Further reductions are expected in the 2004 fiscal year as described below. Revenue sharing payments are affected by reduced sales tax collections; these reductions are further compounded by cuts made by the State to balance its budget.

The original budget for the State's fiscal year ended September 30, 2004 included a three percent reduction in revenue sharing payments from the estimated payments for the State's 2003 fiscal year. The State's most recent revenue estimating conference held in October indicated that sales tax collections are significantly below the estimates used to generate the 2004 budget; as a result, the State has an additional \$900 million shortfall in its budget and further cuts to statutory revenue sharing payments are probable. State revenue sharing payments for 2004, excluding the effect of any additional cuts necessary and expected to balance the State's budget, are estimated to be significantly less than what was received in 2003.

We recommend and it is our understanding that the City will continue to evaluate the impact of the revenue sharing reductions on the 2003-2004 budget. Updated information can be obtained from the Department of Treasury's web site at <http://treas-secure.state.mi.us/apps/findrevshareinfo.asp> or by calling the Office of Revenue and Tax Analysis at (517) 373-2697. We will continue to update the City as developments occur.

PERSONAL PROPERTY TAX

As you may be aware, the State Tax Commission revised the personal property tax tables for utility companies that have caused significant reductions to the taxable value of transmission and distribution property. The changes were effective in 2000, however, the City, like many other communities, has elected to continue to assess these properties using the previous tables. This issue was the subject of a lawsuit brought by several units of government against the State Tax Commission challenging the constitutionality of the new utility personal property tax tables. The use of the new tables was upheld in the lawsuit and the local units of government have appealed this decision.

For the 2002, 2001 and 2000 tax years, the utility companies paid personal property taxes based on the new tables rather than the City assessed amount based on the old tables. The difference between the amount assessed and the amount paid by the utility companies has not been recognized as property tax revenue pending the outcome of the lawsuit appeal.

Furthermore, the utility companies have filed claims relating to personal property taxes paid in years before 2000. The utility companies are attempting to retroactively apply the new tables to the 1997 through 1999 tax years and obtain refunds from local taxing authorities. The resolution of the refund claims will likewise be dependent on the outcome of the lawsuit appeal. The City has set aside reserves in the General Fund for potential refunds in the event an unfavorable outcome. We will continue to keep the City updated as developments occur.

NEW HOMESTEAD AUDIT PROGRAM

Public Act 105 of 2003 provides new authority for local units of government and the Michigan Department of Treasury to share homestead information to determine if a resident is inappropriately claiming a homestead exemption on property. As you recall, following the passage of Proposal A in 1994, individuals in Michigan are allowed only one homestead for property tax purposes. A residence which is not an individual's homestead pays property tax at the non-homestead rate. The Michigan Department of Treasury is expected to publish additional guidance related to this new law. The City of Farmington Hills will be assisted by Oakland County in handling communications related to recording of homestead exemptions.

ELECTRONIC FUNDS TRANSFERS (ACH PAYMENTS)

Recently, Public Act 738 was passed, which allows local units of government to make and accept electronic funds transfers (ACH payments), if the local unit adopts a formal policy. While local units of government may have already been using the ACH system for payroll tax remittances and for the direct deposit of payroll, this new law requires a policy to be adopted.

Beginning immediately, a local unit's governing body may need to adopt a policy on ACH arrangements that includes all of the following:

- Designation of an individual as the party responsible for payment approval, accounting, reporting and compliance with the ACH policy;

- A statement that this individual is required to submit documentation as follows:
 - describe the goods or services purchased,
 - the cost,
 - date of payment, and
 - the department benefiting from the purchase;
- A system of internal controls to monitor the use of ACH transactions; and
- The approval of ACH invoices before payment.

City management should discuss these requirements with legal counsel before formally adopting the City's policy.

CAPITAL ASSETS

With GASB 34 now fully implemented, it is essential that the City continues to track and record all capital asset activity along with the related depreciation on an annual basis. The fixed asset listing was thoroughly reviewed and updated by City personnel in the current year. Going forward the City should adhere to its minimum policy threshold when capitalizing assets and keep a detail list of acquisition and disposition activity during the year. This will streamline the effort needed by the City to report their capital assets in the annual financial statements and assist with capital budget and property insurance planning.

CONDITION OF ACCOUNTING RECORDS

Once again, we would like to compliment the City Council and City Management for the overall positive condition of the City's financial records and related documentation for the fiscal year ended June 30, 2003. Our testing indicated that the City finance and treasury departments continue to maintain strong internal control over cash collection, payroll, and cash disbursement functions. In addition, we wish to congratulate the City on again receiving the prestigious Certificate of Achievement for Excellence in Financial Reporting, which recognizes compliance with the highest standards for preparation of state and local government financial reports for the year ended June 30, 2002.

Honorable Mayor and Members
of the City Council
City of Farmington Hills

October 14, 2003

We would like to thank the Mayor and City Council for the opportunity to serve as auditors for the City. We would also like to thank Mr. Rosch, Ms. Piwowar, the Finance and Treasury Department staffs and all City personnel for the excellent assistance provided to us during the audit. As always, we are pleased to discuss these comments, information presented in the financial statements, or any other matters with you at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



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